

GENERAL INFORMATION

The Community Reinvestment Act (CRA) requires each federal financial supervisory agency to use its authority when examining financial institutions subject to its supervision to assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operations of the institution. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

This document is an evaluation of the CRA performance of **Farmers State Bank, Breckenridge, Michigan**, prepared by the **Federal Reserve Bank of Chicago**, the institution's supervisory agency, as of **March 25, 1997**. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 228.

INSTITUTION'S RATING: This institution is rated Outstanding.

Farmers State Bank promotes economic revitalization and growth, consistent with its size, financial capacity, location, and the assessment area's economic conditions. The bank's efforts are accomplished primarily through the origination of 1-4 family real estate, installment and small business/small farm loans. The bank's average loan-to-deposit ratio of 73.48% supports these efforts. Since September of 1996, 75% of all loans were made within the bank's assessment area and were distributed among borrowers of different income levels and geographies. There is no evidence of discriminatory lending practices, or policies intended to discourage individuals from applying for loans offered by the bank. No CRA-related complaints were received by the bank since the previous examination.

DESCRIPTION OF INSTITUTION

Farmers State Bank, with total assets of \$90.8 million as of December 31, 1996, is a subsidiary of FSB Bancorp, Inc., a one-bank holding company. The bank operates three offices in Michigan, including the main office in Breckenridge and branch offices in Ithaca and Hemlock. The bank offers a variety of deposit products and services, as well as residential, agricultural, commercial and consumer loans. The bank's primary competitors are larger institutions located in neighboring towns: Bank of Alma, Alma with branches in Ithaca and St. Louis; Commercial Bank, Alma with branches in Ithaca, Middleton and St. Louis; Chemical Bank and Trust Company, Midland with branches in Breckenridge and St. Louis; and a branch of NBD Bank, Detroit in Hemlock.

DESCRIPTION OF BANK'S ASSESSMENT AREA

The bank is located approximately 45 miles north of Lansing in Gratiot County, Michigan. The bank's assessment area consists of the majority of Gratiot County and portions of surrounding Midland and Saginaw Counties. The portion of the assessment area in Midland and Saginaw Counties is part of the Saginaw metropolitan statistical area (MSA). The census tracts and block numbering areas (BNAs) included in the assessment area are as follows:

County	BNAs/Census Tracts (CTs)	Location in Relation to Gratiot County
Gratiot	(BNAs) 9901, 9902, 9907, 9908, 9909	N/A
Midland	(CTs) 2913, 2914*	North
Saginaw	(CTs) 121, 122, 123, 124, 125*	West

*moderate-income tracts

Census tract 2914 in Midland County and census tract 125 in Saginaw County are moderate-income tracts; the remainder of the BNAs and census tracts are middle-income. Three BNAs encompassed by the boundaries of BNA 9902 are not included in the bank's assessment area. Historically, the bank has been unable to penetrate this market area, as these BNAs include a number of financial institutions. Two of the three tracts are middle-income and one is upper-income. None of these tracts have over 5% minority populations.

According to 1990 census information, the bank's assessment area has a population of 44,435. Minorities comprise 3.3% of the assessment area's population; individuals of Hispanic origin comprise the largest portion (2.2%) of the minority population. Approximately 19% of the families within the assessment area are low-income and 18.3% are moderate-income. The median family income is \$32,101 for the assessment area, \$27,894 for the non-metropolitan State of Michigan, and \$34,727 for the MSA. Housing in the assessment area consists primarily of owner-occupied, single-family units. Based upon 1990 census information, 79.5% of the housing units in the assessment area are owner-occupied, 15.3% are rental units and 5.2% are vacant units; 84% of the housing units are 1-4 family residences. The assessment area's median housing value of

\$43,378 is below the MSA and non-metropolitan State of Michigan median housing values of \$48,539 and \$44,414, respectively. The assessment area median housing age of 29 years is lower than the MSA (46 years) and non-metropolitan State of Michigan (31 years) median housing ages.

Agriculture and agricultural-related products (dairy farming) are the primary industries in the assessment area. Breckenridge is home to one of the largest grain operators in the nation and a number of retail shops along Breckenridge's main street provide a variety of services to the community. Significant employers in the area include the following:

Employer	City	# Employed	Product\Service
Alma Products	Alma	745	Manufacture of automotive engines
Gratiot Community Hospital	Alma	670	Medical care
Lobdell-Emery Mfg. Co.	Alma	478	Automotive stamping
Michigan Masonic Home	Alma	412	Retirement community
Total Petroleum, Inc.	Alma	287	Refining of petroleum products
United Technologies	Alma	275	Plastic products injection molded
Bear Truss & Components	St. Louis	160	Pre-fabricated roof & floor trusses
Schnepp Health Care Center	St. Louis	140	Nursing
Crippen Manufacturing Co.	St. Louis	115	Grain cleaning, sorting equipment

According to the Michigan Employment Security Commission, unemployment rates were as follows: 6.7% - Gratiot County; 4.8% - Midland County; 5.9% - Saginaw County; and 5.1% - State of Michigan, as of February, 1997.

Discussions with community representatives revealed that the area serves as a bedroom community for the larger cities of Saginaw and Midland. Single-family housing development is sparse, while demand for rental units continues to increase. New housing development has been hindered by local governments' inability to develop an action plan. Renaissance zones, which serve to promote tax free industrial development, have been assigned by the governor and include portions of Gratiot County.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA:

Management has developed adequate policies, procedures, and training programs supporting nondiscrimination in lending activities. The institution is in compliance with the substantive provisions of antidiscrimination laws and regulations, including the Equal Credit Opportunity and Fair Housing Acts.

Loan-to-Deposit Ratio Analysis

The bank's loan-to-deposit ratio for the six most recent quarters ending December 31, 1996 averaged 73.48%. According to the September 30, 1996 Uniform Bank Performance Report (UBPR) the bank's LTD ratio of 76.28% ranks in the 68th percentile of its peer group and exceeds the peer group's LTD ratio of 70.25%. The bank's average LTD ratio is also consistent with the LTD ratios of local competitors of similar asset sizes. The Bank of Alma (assets - \$179 million) and Commercial Bank (assets - \$152 million), both located in Alma, Michigan, had average LTD ratios of 82.44% and 86.39%, respectively.

The bank's loan-to-deposit ratio, considering the bank's asset size, capacity to lend, demographic and economic factors present in the assessment area, exceeds the standards for satisfactory performance.

Lending in Assessment Area

Review of the bank's 1996 Home Mortgage Disclosure Act (HMDA) loan application register (LAR) and a six-month sample of consumer installment loans revealed the following level of lending within the assessment area:

LOAN TYPE	TOTAL LOANS SAMPLED # / (\$000s)	NUMBER OF LOANS WITHIN THE ASSESSMENT AREA # / (\$000s)	PERCENT OF TOTAL # / (\$000s)
Real Estate - Purchase	53 / \$2,359	34 / \$1,277	64.15 / 54.13
Real Estate - Refinancing	89 / \$3,605	71 / \$2,673	79.77 / 74.15
Home Improvement	13 / \$309	13 / \$309	100 / 100
Total Real Estate	155 / \$6,273	118 / \$4,259	76.13 / 67.89
Installment	145 / \$668	120 / \$585	82.76 / 87.57
Total Loans	300 / \$6,941	238 / \$4,844	79.33 / 69.79

As the preceding chart illustrates, 79% of the total number of loans and 69.79% of the total dollar amount of loans were made within the assessment area. The bank's performance of lending to borrowers within the bank's assessment area exceeds the standards for satisfactory performance.

Lending Analysis Based Upon Borrower Income and Size of Business

Lending to Consumers of Different Income Levels

Review of the 1996 HMDA-reportable loans made within the assessment area revealed the following distribution among borrowers of different income levels:

LOAN TYPE	LOANS TO LOW-INCOME BORROWERS	LOANS TO MODERATE- INCOME BORROWERS	LOANS TO MIDDLE- INCOME BORROWERS	LOANS TO UPPER- INCOME BORROWERS	TOTAL
	(\$000s)/#	(\$000s)/#	(\$000s)/#	(\$000s)/#	(\$000s)/#
Real Estate - Purchase	\$18 / 2	\$100 / 5	\$378 / 11	\$753 / 14	\$1,249 / 32
Real Estate - Refinancing	\$75 / 4	\$221 / 8	\$607 / 17	\$1,682 / 40	\$2,585 / 69
Home Improvement	\$6 / 2	\$14 / 3	\$189 / 5	\$100 / 3	\$309 / 13
Total	\$99 / 8	\$335 / 16	\$1,174 / 33	\$2,535 / 57	\$4,143 / 114*

*Loans where borrower income information was available

As illustrated in the preceding chart, the bank made 24 (21%) of the 114 real estate loans to low- or moderate-income borrowers, reflecting the bank's use of flexible loan terms (first mortgage loans are amortized over 30 years, allowing for low monthly payments). Further, the bank regularly finances the purchase of mobile homes that could serve low-income individuals' housing needs.

Because the bank does not collect income information for installment loans, a proxy using loan amount was substituted. Of the total installment loans within the assessment area (120), 55 or 45.83% loans were in amounts of \$2,500 or less. Overall, the median installment loan amount was \$3,166. Loans in amounts as low as \$450 illustrate the bank's commitment in making small dollar amounts loans (which can serve the credit needs of low-income individuals within the assessment area). This level of lending suggests that the bank is making loans available to individuals who may not have access to credit from other sources.

Lending to Small Businesses and Small Farms

Although annual revenue information was not available for the majority of the commercial loans sampled, discussions with management revealed the loans were made to small businesses and small family farm operations. Review of the bank's June 1996 Consolidated Report of Condition revealed that all or substantially all of the dollar volume of small business and small farm loans have original amounts under \$100,000. Additionally, review of the bank's trial balance of loans made since September, 1996 revealed that the bank originated a total of 319

commercial/agricultural loans (totaling \$10.7 million) for an average loan amount of \$33,700. Loan amounts ranged from \$500 to \$400,000; 87 (27%) of the loans were in amounts under \$5,000.

Lending to borrowers of different income levels, and to small businesses and small farms, given the assessment area demographics, is exceptional and exceeds the standards for satisfactory performance.

Geographic Distribution of Loans

Review of the bank's 1996 HMDA LAR and a six-month sample of consumer installment loans revealed the following geographic distribution of loans among BNAs and census tracts within the bank's assessment area:

BNA or Census Tract	Population	Real Estate - Purchase Loans #/(\$000s)	Real Estate - Refinancing Loans #/(\$000s)	Home Improvement Loans #/(\$000s)	Installment Loans #/(\$000s)	Total Loans #/(\$000s)
Gratiot County:						
BNA - 9901	3,609	16 / \$480	27 / \$916	4 / \$75	51 / \$263	98 / \$1,734
BNA - 9902	5,543	1 / \$56	3 / \$99	1 / \$5	20 / \$92	25 / \$252
BNA - 9907	3,947	0 / 0	2 / \$26	0 / 0	1 / \$2	3 / \$28
BNA - 9908	3,925	2 / \$119	1 / \$60	0 / 0	4 / \$23	7 / \$202
BNA - 9909	4,082	5 / \$163	4 / \$148	2 / \$110	14 / \$36	25 / \$457
Midland County:						
CT - 2913	4,337	0 / 0	1 / \$120	1 / \$70	1 / \$4	3 / \$194
CT - 2914 *	3,731	4 / \$153	15 / \$507	2 / \$9	7 / \$50	28 / \$719
Saginaw County:						
CT - 121	4,177	4 / \$227	11 / \$415	0 / 0	4 / \$27	19 / \$669
CT - 122	1,740	1 / \$74	2 / \$106	1 / \$7	6 / \$16	10 / \$203
CT - 123	3,099	0 / 0	4 / \$211	2 / \$33	10 / \$63	16 / \$307
CT - 124	1,944	0 / 0	0 / 0	0 / 0	0 / 0	0 / 0
CT - 125 *	4,301	1 / \$5	1 / \$65	0 / 0	2 / \$9	4 / \$79
TOTALS	44,435	34 / \$1,277	71 / \$2,673	13 / \$309	120 / \$585	238 / \$4,844

*moderate-income census tracts

As illustrated in the preceding chart, the bank has established loan penetration throughout its assessment area, including the two moderate-income census tracts; 19.49% (23 of 118) of real

estate loans and 7.5% (9 of 120) of consumer loans were made in the moderate-income census tracts. No evidence of irregular lending patterns was detected during the examination. The bank's geographic distribution of loans reflects an excellent dispersion in the assessment area and exceeds the standards for satisfactory performance.

Response to Substantiated Complaints

No complaints were received by the bank regarding its CRA performance since the previous examination.